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ACTION EUR-12

INFO OCT-01 ISO-00 EURE-00 SSO-00 NSCE-00 USIE-00 INRE-00

SP-02 AID-05 EB-07 NSC-05 CIEP-01 TRSE-00 SS-15

STR-04 OMB-01 CEA-01 CIAE-00 COME-00 FRB-03 INR-07

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INFO AMEMBASSY DUBLIN

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PASS TREASURY, FEDERAL RESERVE BOARD

E. O. 11652: N/A

TAGS: ECON, OECD

SUBJECT: ECONOMIC AND DEVELOPMENT REVIEW COMMITTEE

(EDRC) REVIEW OF IRELAND, OCTOBER 31, 1975

REF: OECD DOCUMENT EDR(75)27

1. SUMMARY: IN REFDOC CIRCULATED IN PREPARATION FOR OCTOBER 31 EDRC REVIEW OF IRELAND, SECRETARIAT FOCUSES ON RAPID INFLATION, HIGH UNEMPLOYMENT AND PROSPECTIVE DETERIORATION IN REAL EXPORT GROWTH AS MAJOR PROBLEMS FACING IRISH ECONOMY IN 1975 AND 1976. WHILE RECOGNIZING IMPORTANCE OF EXOGENOUS FACTORS SUCH AS OIL AND FOOD PRICE INCREASES AS INFLUENCING CURRENT PROBLEMS, SECRETARIAT CITES DOMESTIC WAGE AND BUDGETARY POLICIES AS SIGNIFICANT CONTRIBUTORY FACTORS AND SUGGESTS NEW INCOMES POLICY INITIATIVES AND INCREASED BUDGETARY EMPHASIS ON CAPITAL SPENDING
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AS REMEDIES. ACTION REQUESTED: (L) MISSION WOULD

APPRECIATE COMMENTS ON POINTS RAISED IN PARAS 4 AND 5 AS WELL AS ANY QUESTIONS THAT COULD BE USEFULLY POSED DURING EDRC REVIEW. (2) FOR DUBLIN, MISSION WOULD WELCOME COMMENTS ESPECIALLY WITH RESPECT TO GOI ABILITY TO SIMULTANEOUSLY RESTRAIN WAGE INCREASES AND REDUCE GOVERNMENT DEFICIT ON CURRENT ACCOUNT. MISSION WELCOMES PARTICIPATION BY BRYON BAAS OF AMEMBASSY DUBLIN IN ANNUAL REVIEW AND WOULD APPRECIATE FURTHER INFORMATION ON MR. BAAS' TRAVEL PLANS AND HOTEL PREFERENCES.

2. BACKGROUND: SECRETARIAT REPORTS THAT DEMAND AND ACTIVITY WEAKENED CONSIDERABLY IN 1974, FALLING 0.3 PERCENT AFTER A RISE OF 8.8 PERCENT THE PREVIOUS YEAR. REAL OUTPUT ROSE ONLY 2 PERCENT IN 1974 DOWN FROM NEARLY 7 PERCENT IN 1973, AS RATE OF INDUSTRIAL PRODUCTION INCREASE DECELERATED SHARPLY AND AGRICULTURAL OUTPUT DROPPED IN ABSOLUTE TERMS FOR THE FIRST TIME IN EIGHT YEARS. LED BY RISES IN FOOD AND OIL PRICES, 1974 CONSUMER PRICES INCREASED BY 17 PERCENT. WAGE INCREASES OF 17 PERCENT UNDER THE NATIONAL PAY AGREEMENT BOTH FUELED INFLATION IN 1974 AND CONTRIBUTED TO THE RISE IN UNEMPLOYMENT TO 12 PERCENT. AGGRAVATED BY RISE IN OIL PRICES IN 1973, THE CURRENT ACCOUNT DEFICIT ROSE TO 300 MILLION POUNDS, OR 10 PERCENT OF GNP IN 1974.

3. OUTLOOK: SECRETARIAT EXPECTS DEMAND AND OUTPUT TO CONTINUE TO WEAKEN IN 1975, WITH GNP FALLING BY 3.75 PERCENT, AND DESPITE INFLATIONARY MEASURES IN 1975 BUDGET, SLUGGISHNESS SHOULD PREVAIL THROUGH 1976. FOR 1975, THE INCREASE IN CONSUMER PRICES MAY BE ABOUT 22 PERCENT. WAGE COSTS CONSTITUTE A MAJOR INFLATIONARY FACTOR IN 1975, WITH UNIT WAGE COSTS RISING 30 PERCENT; 90 OF THIS INCREASE IS ACCOUNTED FOR BY NOMINAL WAGE INCREASES UNDER THE NATIONAL PAY AGREEMENT. REDUCED IMPORTS BECAUSE OF LOW LEVEL OF ECONOMIC ACTIVITY AND

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IMPROVED EXPORT VALUES ATTRIBUTABLE TO HIGHER EXPORT PRICES SHOULD LEAD TO IMPROVED CURRENT ACCOUNT BALANCE IN 1975 WITH CURRENT ACCOUNT DEFICIT NARROWING TO 110 MILLION POUNDS. SECRETARIAT FEELS THAT DETERIORATING COMPETITIVE POSITION COULD REACT ADVERSELY ON EXPORT VOLUME IN 1976, BUT CONTINUED SLOW IMPORT GROWTH AND POSSIBILITY OF IMPROVED EXPORT PRICES (TOGETHER WITH HIGHER EEC CURRENT TRANSFERS) COULD BRING 1976 CURRENT ACCOUNT DEFICIT DOWN TO 70 MILLION POUNDS. SECRETARIAT DOES NOT EXPECT FINANCING OF EXTERNAL DEFICIT TO BE A PROBLEM IN 1976. IN VIEW OF WEAK DOMESTIC DEMAND AND QUESTIONABLE OUTLOOK FOR REAL EXPORTS, SECRETARIAT FORECASTS UNEMPLOYMENT RATE FOR 1976 TO RISE ABOVE 12 PERCENT PREDICTED FOR 1975.

4. POLICY RECOMMENDATIONS: SECRETARIAT ISOLATES HIGH UNEMPLOYMENT, RAPID INFLATION AND DETERIORATING EXTERNAL COMPETITIVENESS AS CRUCIAL PROBLEMS. REALIZING LIMITED OFFICIAL USE

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THAT WAGE INCREASES UNDER PAY AGREEMENT AGGRAVATED RECENT INFLATION, SECRETARIAT RECOMMENDS NEW INCOMES POLICY INITIATIVES AS CORRECTIVE MEASURES. LOW INCOME ELASTICITY OF TAX REVENUES AND GOVERNMENT EFFORTS TO INCREASE TRANSFERS TO SOFTEN IMPACT OF INFLATION ON REAL INCOMES HAVE DANGEROUSLY INCREASED GOVERNMENT'S CURRENT ACCOUNT DEFICIT AND RESULTED IN AN UNDESIRABLE DEEMPHASIS ON CAPITAL EXPENDITURES TO THE DETRIMENT OF INVESTMENT. SECRETARIAT BELIEVES THIS COULD HAVE SERIOUS MEDIUM-TERM CONSEQUENCES ON IRISH PRODUCTIVITY IN GENERAL AND ON COMPETITIVE POSITION IN PARTICULAR.

SECRETARIAT THUS RECOMMENDS THAT SAVINGS BE EFFECTED ON CURRENT ACCOUNT FOR TRANSFER TO CAPITAL ACCOUNT OF BUDGET.

5. COMMENT: SECRETARIAT RECOMMENDATIONS DIRECTED TOWARD REDUCING WAGE SHARE THROUGH MORE AMBITIOUS INCOMES POLICIES UNDER THE NATIONAL PAY AGREEMENT, AND CHANNELING PUBLIC FUNDS INTO INVESTMENT (AND AWAY FROM CURRENT TRANSFERS) ARE COGENT BUT MAY BE DIFFICULT TO IMPLEMENT SIMULTANEOUSLY IN TIMES OF HIGH INFLATION AND FALLING REAL INCOMES. AN ALTERNATIVE COULD BE TO INCREASE PUBLIC EXPENDITURE ON INVESTMENT WHETHER OR NOT IT IS POSSIBLE TO REDUCE THE CURRENT ACCOUNT DEFICIT, THEREBY USING SHORT-TERM INFLATION TAX TO EFFECT RESOURCE TRANSFER AND MEDIUM-TERM PRODUCTIVITY INCREASE. MISSION WOULD SEEK TO SOLICIT IRISH VIEWS ON THIS COURSE OF ACTION BY QUESTIONING IRISH DEL AS TO WHETHER INVESTMENT SPENDING WOULD BE REDUCED IF NO SAVINGS WERE POSSIBLE IN CURRENT GOVERNMENT SPENDING. IN ADDITION, IT MAY BE MORE APPROPRIATE TO FOCUS ON WHAT THE BARRIERS ARE TO INCREASED PRIVATE INVESTMENT RATHER THAN ASSUMING THAT INCREASED DIRECT PUBLIC INVESTMENT IS NECESSARILY DESIRABLE.
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